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C O N F I D E N T I A L SECTION 01 OF 03 SANTO DOMINGO 006999

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JUSTICE FOR OIA

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TAGS: [EFIN](#) [ECON](#) [ECIN](#) [DR](#)

SUBJECT: PRESIDENT MEJIA SETS UP INVESTIGATION TO GET THE
DOMINICAN EXCHANGE RATE RIGHT

Classified By: DEPUTY CHIEF OF MISSION LKUBISKE. REASON 1.5 (B&D)

11. (U) Summary. In a December 2 meeting, President Mejia insisted that the exchange rate must go down sharply and told attendees that military and police officers will be watching exchange houses to detect questionable transactions. Most exchange houses have agreed not to sell dollars for more than RD40 to dollar. The Government asserts that it is not instigating exchange controls but instead wants the rate to return what it should be -- about 30 to the dollar, according to some. So-called voluntary agreements to sell dollars at a set rate have regularly been tried in Dominican history, with short-lived results. The use of military and police is new. Mejia has reiterated his commitment to reaching agreement with the IMF on a revised program. The Central Bank will publish a communique tomorrow (see final para below), stressing its aim of deterring criminal behavior. Ambassador and emboffs raised questions on December with a wide range of contacts and stressed the impact that the poorly explained initiative could have on business confidence and the value of the peso. Exchange trading is routine but thin today, at RD 40 for the dollar. Dollars may become even more scarce in coming days. End summary.

BACKGROUND

12. (SBU) After the peso broke the RD\$40 per dollar barrier again in November and continued to weaken, rumors began to surface in late November about GODR plans to address the crisis. Receiving increasing complaints about the depreciation of the currency, the President publicly blamed it on "manipulation" by currency trading houses - which handle roughly 70 percent of all foreign exchange trading in the Dominican Republic -- and issued warnings about possible arrests for illegal hoarding of dollars.

A SHOW OF FORCE

13. (C) Immediately following a meeting with his monetary board December 2, President Mejia harrangued a large meeting of private and public sector representatives on the "unacceptable" level of the exchange rate, asserting that the IMF agreement being revised would become impossible if the dollar remained at 45 pesos. The palace had convened exporters, tourism representatives, local bankers and foreign exchange traders; Mejia was flanked by administration officials, all of the military chiefs, the Governor of the Central Bank, and police officials. He announced the formation of a commission to investigate abuses in the exchange sector, composed of director of internal taxes Teofilo Tabar, Secretary of the Armed Forces General Jose Miguel Soto Jimenez, former national police chief under Balaguer's administration General Rafael Peralta Guerrero, and former national police chief during the Fernandez administration (and the first year of the Mejia administration) General Pedro de Jesus Candelier. We understand that a banking superintendency official will also participate. The President's tough intent was clear. Previous governments have resorted to jawboning and temporary pacts on the rate; this is the first time that the military and police have been associated with one. Embassy does not know whether the President's new commission has received any charter or written instructions for its work, nor what exactly it will do.

14. (C) The Dominican financial team has been examining irregularities in the exchange system over the last several weeks. Among concerns which they had notified to Mejia were avoidance of taxation by exchange houses, operation of unlicensed exchange operations, and some large transactions by unknown individuals, in the range of USD 5 to 10 million. Banking Superintendent Julio Cross and presidential Technical Secretary Carlos Despradel have assured us that these suspicious activities are to be the focus of the investigations. Despradel says that banking Superintendency personnel will be sent to at least some of the exchange houses to inspect and watch their operations. The GODR denied reports that uniformed military personnel would be posted at branches of the four major currency trading houses, though it acknowledged having been tasked to identify the

location of exchange houses. During an afternoon visit to the leading exchange house, Embassy staff saw no military presence; Embassy Defense Attache learned from a military contact that no order has been issued on the subject.

15. (C) Bankers and currency traders acceded "voluntarily" under this pressure to cap the price of the dollar at 40 pesos. In the discussions some exchange house representatives suggested that dollar purchases be set at RD38/1 by December 7 and then reduced progressively by 2 pesos per week until reaching a level between RD30 to RD32 per dollar. Banking Superintendent Cross dismissed this scheme, commenting that the proposal was evidence that manipulation was already occurring in the markets.

MONETARY BOARD INSIDER

16. (SBU) Monetary Board Member Sonia Guzman (GODR Secretary of Industry and Commerce) commented to Econoff December 3 that the IMF had made its most recent calculation for a new standby agreement based on a projected exchange rate of RD40 per dollar. She confirmed that Mejia had said in the meeting that there was zero chance of signing an agreement if the IMF had calculate the rate again due to depreciation. Guzman said that Mejia is committed to reaching agreement with the IMF "no matter what the political costs," but that to do so the GODR had to bring the exchange rate under control.

17. (C) Guzman said that Mejia was disgusted at the shortfall in voluntary contributions provided by exporters and tourism operators toward fiscal goals. When Finance Minister Calderon reported contributions at only RD 74 million (scarcely more than USD 2 million), far short of projections, Mejia was so infuriated that he ordered the Minister to return all of the money. (Guzman said she would approach the President to convince him that the GODR should retain at least the free trade zone companies' contributions.)

A "VOLUNTARY" RATE

18. (C) Embassy obtained a copy of a circular notice sent out by the association of exchange houses on December 2 advising members that the meeting had agreed that the rate would not exceed RD40, and that "respect for this measure is obligatory." In fact, banks and exchange houses were posting rates in this range today -- but volumes were low and some houses were refusing to deal at all. One operator of a legitimate exchange house commented that he was not concerned at all by the enforcement measures (aimed at questionable operations) or by the rate.

EMBASSY INVESTIGATION AND ADVOCACY

19. (SBU) In the course of December 3 Ambassador and Embassy officers contacted a wide spectrum of government and private sector actors, seeking clarification about these events and stressing the importance of preserving the free functioning of the exchange markets. Emboffs stressed the need for the GODR to make clear its measures and intentions in order to prevent the gathering alarm. Presidential Technical Secretary Despradel, in a late afternoon visit to the Embassy, told Ambassador that in response the government had thought of issuing a message from the cabinet, but had settled on a communique from the Central Bank as more appropriate and easier to complete. He subsequently faxed the version to the Embassy. To be released tomorrow, December 4, it emphasizes the GODR adherence to the aim of free competition in a properly regulated market and advises of the intention to investigation financial irregularities such as money laundering. The communique does not address the "agreed" rate in the market. (See informal translation below.)

COMMENT

110. (C) Mejia's measures were a triumph of political grandstanding and a unsustainable approach to the exchange market. A certain amount of clean-up in the sector will do everyone some good and could yield tax revenues and fines. But the President's choice of muscle for the committee was, in our opinion, a grave mistake. The Armed Forces have no technical competencies in this area, other than the intelligence operations of last week to scout out the location of unlicensed exchange houses. And Mejia's appointment of Police General Pedro Candelier is a heavy handed, empty threat of force. (NOTE: Candelier was notorious for corruption and for tolerating extrajudicial police killings during his tenure as National Police Chief.)

111. (SBU) Begin text of informal translation of Central Bank communique to be released on December 4:

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CENTRAL BANK COMMUNIQUE TO THE NATION

The Central Bank and the Banking Supervision authorities wish to inform the public concerning the outcome of the meeting of Tuesday, December 2, in the presidential palace chaired by the President of the Republic and attended by the monetary, fiscal and security authorities as well as representatives of the banks, exchange houses and private sectors which earn foreign currency.

11. The reunion of the authorities with the sectors participating in the exchange market had as its aim the identification of measures to contribute to an environment favorable to stabilizing exchange operations and normalizing their functioning, in conformity with the laws regulating the markets.

In their comments to the press, the principal spokespersons of the banks and the exchange houses emphasized the interest they share with the authorities in supporting the elimination of extra-market factors which prevent the exchange rate from corresponding to real values.

12. Exchange operations are carried out in the Dominican Republic in the framework of a free market, with the assistance and safeguards of measures in the Monetary and Financial Law and the regulations established by the Monetary Board. As occurs with any institutionalized market, its functioning is bound up with the privileges of the agents participating in the market, which bring with them the duty to respect established norms and procedures.

13. As in any nation of organized institutions, exchange operations are supervised by the government authorities and are carried out according to norms and formal procedures that must be respected by law. Fundamentally, the market is a service offered to its clients by entities that are constituted under law according to principles of transparency and certified competence.

14. On the other hand, it should be remembered that the Dominican Republic is signatory to a number of international agreements and bilateral cooperation agreements which oblige the country to remain vigilant and to prosecute crimes considered by the international community to be extremely serious, including money laundering, whether originated by narcotics trafficking, tax evasion, financial fraud, or terrorist financing. These obligations involve responsibilities that must be complied with not only to protect its own citizens, but also to contribute to the security of other nations. With this aim, the appropriate institutions are investigating exchange operations considered to be unusual, both for their amounts and because of their form -- one of the principal themes discussed in the meeting.

15. In conclusion, the monetary authorities confirm once again their adherence to a system of free exchange and to the promotion of competition, by means of which they are confident that stability and necessary transparency will be re-established in the exchange market, in benefit of all the clients of its services, the regular functioning of the productive activity of the nation, and the economic security of the Dominican people..(end text)

HERTELL